WEEKLY ECONOMIC UPDATE

16 – 22 July 2018

The last few days have brought some relief for the CEE currencies and bonds after a sharp weakening recorded in the previous weeks. Despite another round of the trade war, demand for risky assets remained decent, helping EURPLN, EURHUF and EURCZK stay below the local peaks and allowing bond yields to fall slightly. The MPC kept interest rates unchanged and the new NBP projection did not give any more arguments to consider policy change than its earlier version. Final June CPI showed 2.0% y/y print and the rise was mainly caused by higher food and fuel prices. We estimate that core CPI remained unchanged.

This week, numerous US data are on the agenda, including industrial output and retail sales. US June inflation rose to its highest since early 2012 and the economic activity data could verify if the scenario of two more rate hikes this year is likely. In Poland, June industrial output and retail sales will be published. Industry will be supported by positive working-day effect, but also by strong data on German industry. Sales should revive after weaker May due to combination of holidays. Our forecasts are above market consensus and should confirm that 2Q GDP could be near 5% again. Politicians are still very active and we should assume that more comments about trade relationships or geopolitical issues would emerge in the coming days.

Economic calendar

TIME CET	COUNTRY	INDICATOR	PERIOD		FORECAST MARKET	FORECAST BZWBK	LAST VALUE
		MONDAY (16 July)					
14:00	**PL**	**CPI Core**	**Jun**	**% y/y**	**0.6**	**0.52**	**0.5**
14:00	**PL**	**Current Account Balance**	**May**	**€mn**	**52**	**-563**	**-21**
14:00	**PL**	**Trade Balance**	**May**	**€mn**	**-129**	**-272**	**314**
14:00	**PL**	**Exports**	**May**	**€mn**	**17 325**	**17 148**	**17 176**
14:00	**PL**	**Imports**	**May**	**€mn**	**17 410**	**17 420**	**16 862**
14:30	US	Retail Sales	Jun	% m/m	0.6	-	0.8
		TUESDAY (17 July)					
10:00	**PL**	**Employment in corporate sector**	**Jun**	**% y/y**	**3.7**	**3.62**	**3.7**
10:00	**PL**	**Average gross wages in corporate sector**	**Jun**	**% y/y**	**7.0**	**7.75**	**7.0**
15:15	US	Industrial Production	Jun	% m/m	0.55	-	-0.09
		WEDNESDAY (18 July)					
10:00	**PL**	**Sold Industrial Output**	**Jun**	**% y/y**	**5.95**	**7.01**	**5.4**
10:00	**PL**	**Construction Output**	**Jun**	**% y/y**	**20.35**	**19.54**	**20.8**
10:00	**PL**	**PPI**	**Jun**	**% y/y**	**3.65**	**3.45**	**2.8**
10:00	**PL**	**Consumer Confidence**					
11:00	EZ	HICP	Jun	% y/y	2.0	-	2.0
14:30	US	Housing Starts	Jun	% m/m	-1.74	-	5.0
20:00	US	Beige Book					
		THURSDAY (19 July)					
14:30	US	Initial Jobless Claims	week	k	225	-	214
14:30	US	Index Philly Fed	Jul	pts	20.5	-	19.9
		FRIDAY (20 July)					
10:00	**PL**	**Retail Sales Real**	**Jun**	**% y/y**	**6.8**	**7.3**	**6.1**
10:00	**PL**	**Stats Poland business sentiment**					

Source: BZ WBK, Reuters, Bloomberg

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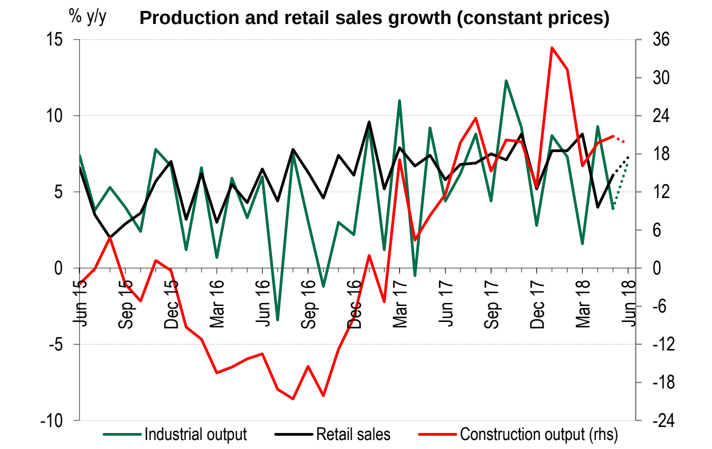
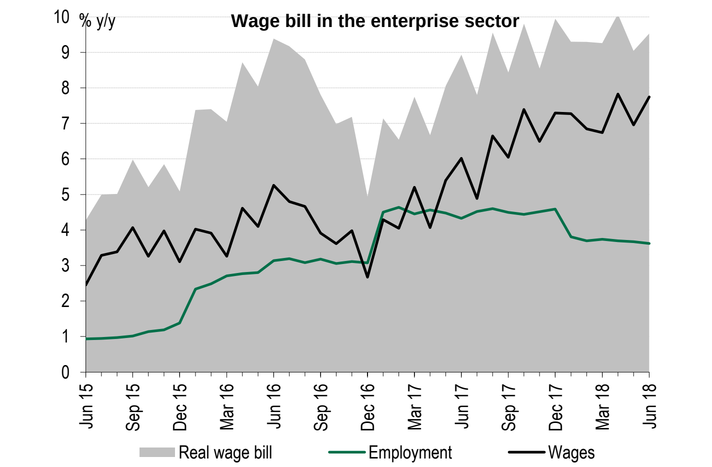
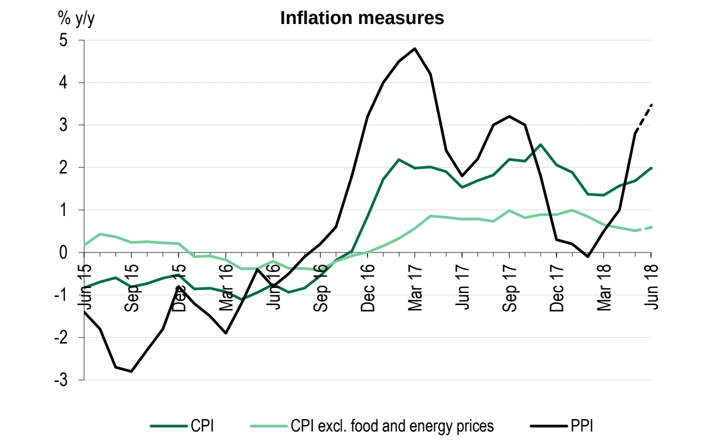
What's hot next week – Set of important macro data





- It seems positive employment trends are losing momentum, as employment growth this year is markedly lower than in 2016 and 2017. Thus, we are expecting employment growth to slow down to 3.6% y/y. Wage growth, on the other hand, is likely to accelerate, given better working-day effect than in May and hikes in the mining industry.
- We expect the industrial output to accelerate in June. The sector will be supported by positive working-day effect. The improvement in May data from Germany also bodes well for the Polish manufacturing. Our forecast for output is above the market consensus. Construction, on the other hand, did not accelerate in June versus May, in our view. We expect the sector to be slowing down in the months to come.
- Retail sales will also show a stronger print in June, according to our forecasts. May result was undermined by combination of holidays, creating much space for long weekends. This, together with positive weather conditions, discouraged consumers from visits in shops. This was no longer the case in June. We expect private consumption to remain the main driver of growth this year.
- We forecast the PPI inflation to jump above 3% y/y on weaker zloty and higher commodity prices. Usually higher PPI precedes spikes in CPI.
- Foreign trade data released by the stat office showed that in May exports amounted to €18.9bn and imports to €18.6bn. In both cases, these readings suggest an upside risk to our forecasts of balance of payments data to be released on Monday by the central bank (€17.1bn and €17.4bn, respectively). The risk looks bigger for exports and so the trade balance and current account could be above our expectations.

Last week in economy – CPI at 2% again



- Inflation rose from 1.7% y/y to 2.0% in June, after 0.1% m/m rise in prices. The rebound of inflation was caused by food and fuel prices. Core inflation is still showing no reaction to the tight labour market with its wage pressure. According to our estimate, core inflation ex food and energy remained in June at 0.5% y/y, its lowest level since February 2017.
- Fuel prices are up 15.2% y/y and 1.1% m/m while food prices increased 2.7% y/y (-0.2% m/m) – in both categories there were no changes vs the flash estimate.
- CPI inflation may stay around 2% also in July, but in the following months the base effects should exert negative pressure and bring it down to c1.5% at the end of the year. There is a slight upside risk to our CPI forecasts due to the drought in Poland. Currently we estimate that if damage to crops proves to be significant, it could add 0.1-0.2 pct. points to the inflation path later this year.

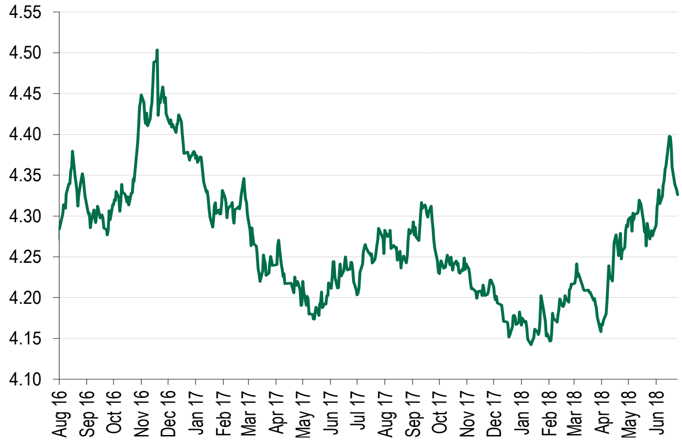
Quote of the week – New NBP projection not supporting any policy change

	GDP growth			
	Jul 17	Nov 17	Mar 18	Jul 18
2018	2.5÷4.5	2.8÷4.5	3.5÷5.0	4.0÷5.2
2019	2.3÷4.3	2.3÷4.3	2.8÷4.8	2.8÷4.7
2020	-	-	2.6÷4.6	2.4÷4.3
	CPI inflation			
2018	1.1÷2.9	1.6÷2.9	1.6÷2.5	1.5÷2.1
2019	1.3÷3.6	1.7÷3.7	1.7÷3.6	1.9÷3.5
2020	-	-	1.9÷4.1	1.7÷3.9

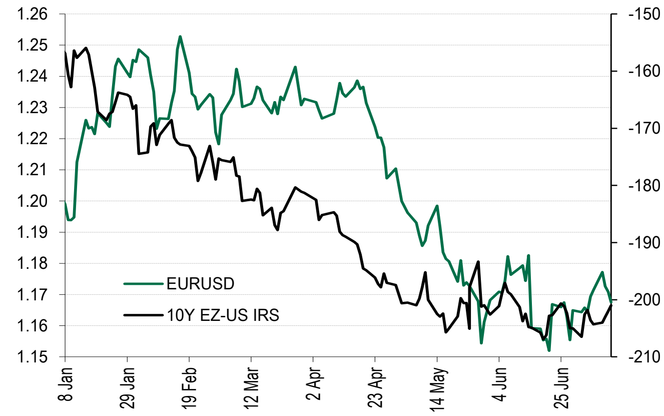
The MPC kept interest rates unchanged, as expected. The new NBP projection shows slightly lower path of CPI in 2018 and 2020 compared to March. Yet, CPI is still expected to head above the official 2.5% target in 2019-20. GDP projection has been increased for 2018 and lowered slightly for 2019-2020. The new NBP projection did not give any more arguments to consider policy change than its earlier version. Thus, our expectations regarding the monetary policy outlook remain unchanged. We think that the main interest rates will remain flat at least until November 2019. The first rate hike is possible at the very end of 2019, in our view, if the economic growth remains decent, inflation exceeds the target with no signs of upward trend coming to an end, and the ECB starts lifting interest rates as well.

FX and FI market – Polish data supportive for bonds, neutral for zloty

EURPLN

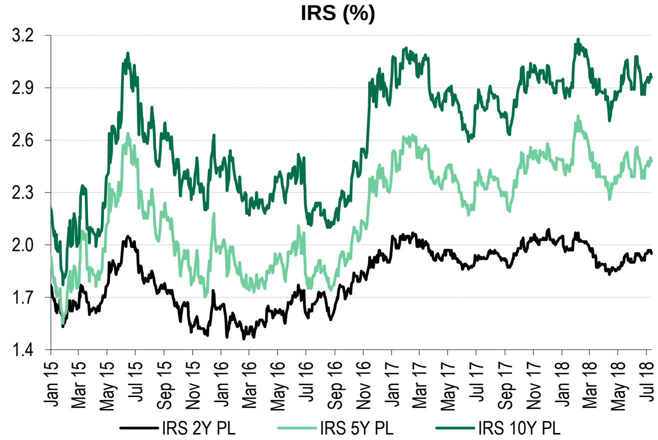


EURUSD and 10Y IRS EZ-US spread



Poland 2-10 bond yield spread (bp)

IRS (%)



CEE currencies recover, yields slightly down

- **FX** The last few days have brought some relief for the zloty and its CEE peers after a sharp weakening recorded in the previous weeks. Despite the next round of the trade war, demand for risky assets remained decent, helping EURPLN, EURHUF and EURCZK stay below the local peaks.
- **FI** Poland bond yields fell 1-3bp while the IRS rates rose at a similar scale, leading to narrowed asset swap spreads. Polish debt outperformed Bund with the 10Y PL-DE falling to c285bp vs nearly 300bp at the beginning of July. Poland bond curve flattened a bit while the IRS steepened marginally.
- The Ministry of Finance sold bonds for PLN5.9bn at the switch auction.

What to watch for next week

- This week, numerous US data are on the agenda, including industrial output and retail sales. US June inflation rose to its highest since early 2012 and the economic activity data could verify if the scenario of two more rate hikes this year is likely.
- In Poland, June industrial output and retail sales will be published. Our forecasts are above market consensus and should confirm that 2Q GDP could be near 5% again.
- Politicians are still very active and we should assume that more comments about trade relationships or geopolitical issues would emerge in the coming days.

Market implications

- **FX** Politics is still a relevant driver for the market but the last few days have shown that after a sharp depreciation in the previous weeks now the currencies became somewhat more resilient to information about next planned tariffs to be imposed. Although this may not be enough to gain noticeably, the room for any significant depreciation driven by politics looks to be limited in the short term.
- The market has largely priced in the coming Fed rate hikes and it seems that the upcoming US data releases could have a bigger market impact if they surprise to the downside. Should this be the case, higher EURUSD could help pull EURPLN lower.
- We do not expect domestic data to have any meaningful impact on the zloty since the MPC sounded dovish and there seems to be no chance for a rate hike in the months to come.
- **FI** The 10Y bond yield is testing the 3.20% support again and we think that the second try could be successful. In our view, the liquidity situation could be supportive for bonds in the weeks to come as nearly PLN15bn will flow into the market this month from redemptions and coupon payments. Also, the planned supply at a regular auction is at PLN4-8bn. As a result, the 2-10 bond yield spread could near the 150bp support level.
- Final June CPI was at 2.0% y/y (above flash estimate at 1.9% and 1.7% in May) but there should be hardly any reaction to this release after the dovish message sent by the MPC during the last press conference. Positive surprises expected by us in the retail sales and industrial output data could be viewed in the context of the state budget performance that could be still solid, given the continuation of robust economic growth.

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